

ST 02-6

Tax Type: Sales Tax

Issue: Exemption From Tax (Charitable or Other Exempt Types)

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS**

THE DEPARTMENT OF REVENUE)	
OF THE STATE OF ILLINOIS)	
)	Docket No. 01-ST-0000
v.)	
)	
ABC SEMINARY &)	
)	Claim for Exemption
Taxpayer)	

RECOMMENDATION FOR DISPOSITION

Appearances: Kent Steinkamp, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; James B. Kinzer of Razzano & Kinzer for ABC Seminary.

Synopsis:

ABC Seminary ("taxpayer") applied to the Department of Revenue ("Department") for an exemption identification number so that it could purchase tangible personal property at retail free from the imposition of use and retailers' occupation taxes. The Department denied the application, and the taxpayer timely protested the denial. An evidentiary hearing was held during which the sole issue presented was whether the taxpayer is organized exclusively for educational purposes under section 3-5(4) of the Use Tax Act (35 ILCS 105/3-5(4)) and section 2-5(11) of the Retailers' Occupation Tax

Act (35 ILCS 120/2-5(11)). After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer is a non-profit corporation that was incorporated in Illinois on October 9, 1882. (Taxpayer Ex. #1; Tr. p. 7)

2. The taxpayer's charter provides that "[t]he objects and business of such Corporation [the taxpayer] is the establishment of an institution of learning for the education of persons of both sexes also for the conferring of such literary degrees titles and honors as may be appropriate upon the completion of the courses of study prescribed by the authorities of the institution or such as may be conferred pro merito or pro caus a honoris." (Taxpayer Ex. #1)

3. The taxpayer originally operated as both a high school and a seminary. It subsequently operated only as a high school. In 1919, it became a military school and operated as a military school until 1972. Because the interest in military schools had decreased significantly by 1972, the taxpayer ceased its operations as a military school, and its premises became vacant. The taxpayer's premises remained vacant for nearly 20 years because the taxpayer was unable to operate its facilities as an educational institution during that time period. (Tr. pp. 11, 13-14)

4. In March of 1991, the taxpayer began leasing its premises to XYZ, which is a not-for-profit corporation, for the purpose of offering education and therapy programs. (Taxpayer Ex. #2; Tr. p. 11)

5. Since 1991, XYZ has operated a high school at the taxpayer's facilities for teenagers who have a history of sexually abusing others. The students are sent there

because they are deemed to be a danger to the children in the public schools. XYZ also believes that isolating these students from other influences allows them to concentrate on their own issues. (Tr. pp. 12, 17, 34)

6. The lease agreement between the taxpayer and XYZ provides that the premises are to be used by XYZ “solely for the purpose of conducting a private school and any allied or supplemental use necessarily incident to the operation of such a school, including, without limitation, providing sex-offender and substance abuse therapy, and related counseling and evaluation.” (Taxpayer Ex. #2)

7. The taxpayer’s facilities are located in Anywhere, Illinois and include classrooms, dormitories, a cafeteria, gymnasium, swimming pool, athletic field and auditorium. (Tr. pp. 10, 14)

8. The taxpayer does not own stock in XYZ and does not supervise its functions. (Tr. p. 15)

9. During 1997 and 1998, the taxpayer received rental and farm income. During 1997, the farm income was approximately 62% of the taxpayer’s total operating income. During 1997 and 1998, the taxpayer also had school and farm expenses. The farm expenses were approximately 40-44% of the operating expenses for those years. (Dept. Ex. #3)

10. XYZ provides juvenile sex offender treatment and subcontracts out the education that is provided. XYZ receives all of its funding from public sources. (Tr. p. 27)

11. The teachers at the taxpayer’s facilities are from the ABC Special Education Co-op. They provide educational programs that are identical to the ones offered in the

public school system. They are paid and supervised by ABC Special Education Co-op.
(Tr. pp. 16, 33, 38)

12. When the students graduate from the program at XYZ, they receive a diploma from the local high school. XYZ does not issue a diploma to them. (Tr. pp. 34-35)

13. The Department's denial of the taxpayer's application for an exemption identification number was admitted into evidence under the certificate of the Director of the Department. (Dept. Ex. #1)

CONCLUSIONS OF LAW:

The Use Tax Act ("Act") (35 ILCS 105/1 *et seq.*) imposes a tax upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. 35 ILCS 105/3. Section 3-5 of the Act provides a list of tangible personal property that is exempt from the tax, and includes the following:

“(4) Personal property purchased by a governmental body, by a corporation, society, association, foundation, or institution organized and operated exclusively for charitable, religious, or educational purposes ***. On and after July 1, 1987, however, no entity otherwise eligible for this exemption shall make tax-free purchases unless it has an active exemption identification number issued by the Department.” (35 ILCS 105/3-5(4))

Section 2-5(11) of the Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*) contains a similar provision. The Department's initial tentative denial of the taxpayer's claim for an exemption identification number is presumed to be correct, and the taxpayer has the burden of clearly and conclusively proving its entitlement to the exemption. See Wyndemere Retirement Community v. Department of Revenue, 274 Ill.App.3d 455, 459 (2nd Dist. 1995); Clark Oil & Refining Corp. v. Johnson, 154 Ill.App.3d 773, 783 (1st Dist. 1987). To prove its case, a taxpayer must present more than its testimony denying the Department's determination. Sprague v. Johnson, 195 Ill.App.3d 798, 804 (4th Dist.

1990). The taxpayer must present sufficient documentary evidence to support its claim. Id. It is well-settled that tax exemption provisions are strictly construed and all doubts are resolved in favor of taxation. Heller v. Fergus Ford, Inc., 59 Ill.2d 576, 579 (1975).

The Department contends that the taxpayer is not entitled to an exemption number because its primary source of income is rental income from XYZ, and its secondary source of income is from farming operations. The Department relies on the case of Methodist Old Peoples Home v. Korzen, 39 Ill.2d 139 (1968), where the court established guidelines to consider when assessing a corporation's charitable status. One of the factors to consider is whether there is capital stock, shareholders or profits and whether the organization derives its funds mainly from public and private charity. The Department claims that because the taxpayer receives rental and farming income, this makes the taxpayer ineligible for the exemption number.

The Department also states that under the broad category of charitable exemption, the taxpayer is seeking an educational exemption, which requires two things. First, the taxpayer must offer a course of study that fits into the general scheme of education established by the state, and second, it must lessen the burden of government by providing an education that would otherwise have to be furnished by the state. The Department argues that whether XYZ meets these requirements is irrelevant because the taxpayer is the entity that must meet the requirements. The Department claims that the taxpayer is simply a landlord and does not conduct charitable activities under the laws of the state.

The taxpayer contends that it is not simply a landlord because its charter creates a legally enforceable obligation to use its facilities for education. A typical landlord is able

to use its building for any purpose, but the taxpayer has a duty to use the facilities for educational purposes. The taxpayer argues that other public high schools sometimes subcontract out their educational services. For example, the ABC Special Education Co-op provides educational services at other schools in Anywhere County, and this does not preclude those schools from being considered educational institutions. The taxpayer also states that XYZ' services relieve the residents of Anywhere County of the burden of providing a secure educational facility for these children. The students at the taxpayer's facility are receiving a high school education, which is mandated by the State, and this relieves the taxpayers of their burden of housing and supervising these children who are a danger to the community.

Although the Department contends that the educational exemption is a subcategory of the charitable exemption, section 3-5(4) of the Act allows an exemption for property purchased by a corporation "organized and operated exclusively for charitable, religious, **or** educational purposes." (emphasis added; 35 ILCS 105/3-5(4)). The educational exemption is separate and distinct from the charitable exemption. If a corporation is organized and operated exclusively for educational purposes, then it is entitled to make purchases of tangible personal property without paying retailers' occupation or use taxes even if the corporation does not meet the guidelines that are usually considered in determining whether a corporation is charitable.

In determining the purpose for which a corporation is organized, reference must first be made to the corporation's charter. In this case, according to the taxpayer's charter, the taxpayer was organized to establish "an institution of learning for the education of persons of both sexes also for the conferring of such literary degrees titles

and honors as may be appropriate upon the completion of the courses of study prescribed by the authorities of the institution or such as may be conferred pro merito or pro caus a honoris.” This provision indicates that the taxpayer was organized for the purpose of providing an education. The next question is whether the taxpayer is operated for educational purposes.

Based on the evidence submitted, the taxpayer has not met its burden of proof that it is operated exclusively for educational purposes. The Department’s regulation concerning exempt organizations provides that “if a substantial purpose or activity of the purchaser is not charitable, religious or educational, the Department will not consider the purchaser to be organized and operated exclusively for charitable, religious or educational purposes within the meaning of the Act.” 86 Ill.Admin.Code §130.2005(n)(2). The taxpayer’s financial statements that were submitted by the Department show that during 1997, 62% of the taxpayer’s operating income was from farming, and the taxpayer also had farming expenses. The taxpayer did not submit more recent financial statements, but the chairman of the Board of Trustees testified that the taxpayer’s two sources of income are (1) rent income for the school facilities and (2) income from “endowed farmground.” (Tr. p. 21). The chairman testified that the taxpayer’s endowment will lapse if the taxpayer ceases to operate as an educational institution (Tr. p. 13), but the taxpayer did not present documentary evidence supporting this contention. Moreover, the chairman testified that the taxpayer continued to receive its endowment during the years that its premises were vacant and were not being operated for educational purposes. (Tr. p. 21) Because the taxpayer has the burden of clearly and conclusively proving its entitlement to the exemption, it cannot be found that the taxpayer

is operating exclusively for educational purposes. From the evidence presented, it appears as though a substantial portion of the taxpayer's income is from farming operations rather than educational activities.

Furthermore, to support its position that it is entitled to an exemption number as an entity organized and operated for educational purposes, taxpayer focuses on the use of its property by another separate and distinct corporation. This focus is misdirected. The exemption sought is not from property tax, but rather from sales taxes paid by an entity on all of its retail purchases in Illinois. As such, the focus must be on the conduct of the taxpayer seeking this exemption privilege.

In this case, the evidence supports a finding that the taxpayer is primarily a landlord. In addition to the farming income, the remaining income that the taxpayer receives is rental income. In fact, the taxpayer, itself, provides no educational services.

Tax exemption provisions are strictly construed and all doubts are resolved in favor of taxation. Heller at 579. The evidence indicates that the taxpayer is operating its facilities as a landlord, and the taxpayer has the traditional remedy of raising its rent to compensate for additional expenses. The lease agreement between the taxpayer and XYZ provides that the rent will increase from \$17,500 per month to \$28,000 per month once a new dormitory is completed. (Taxpayer Ex. #2). Under these facts, it cannot be found that the taxpayer is organized and operated exclusively for educational purposes.

Recommendation:

For the foregoing reasons, it is recommended that the Department's determination be upheld.

Enter: January 29, 2002

Linda Olivero
Administrative Law Judge